# I. INTERCARRIER COMPENSATION PROPOSAL

This Intercarrier compensation proposal is based on the NARUC Statement of Principles and the five workshops the NARUC Task Force on Intercarrier Compensation has held.

## Origination and Termination

1. **Intercarrier compensation for origination and termination should be unified at rates that are based on forward-looking economic (not embedded) costs and are economically viable in a competitive market environment. Unified means that the rates should be the same for all traffic in both interstate and intrastate jurisdictions, the same for all interconnecting carriers, and the same for exchange and exchange access interconnection.**

2. **The origination rate should be zero, as it is today for intercarrier reciprocal compensation, unless a unified origination rate plan can be developed that meets the requirements of 1. and is permissible under Sections 251 and 252 of the Communications Act. An origination rate plan must be competitively neutral and must not impose unfair financial burdens on interexchange carriers. One concept for such an origination rate plan is attached.**

In order for intercarrier compensation to be unified, a unified rate must be applied in a uniform manner. Today, reciprocal compensation for local intercarrier traffic is based on the transport and termination framework established in Sections 251 and 252 of the Communications Act. Intercarrier compensation for exchange and interexchange traffic must be applied uniformly in order for the requirements of 1. to be satisfied. Furthermore, it is nearly impossible to levy originating intercarrier compensation charges in instances where VOIP or special access is used. Therefore, eliminating the origination charge will minimize the opportunity for arbitrage and for the stranding of existing useful circuit switched investment in order to avoid paying an origination charge.

3. **In the absence of a negotiated intercarrier agreement, ILECs should be required to adopt unified termination charges by category of wire center as follows:**[1]

| Access Lines in Wire Center | Approximate Percentage of Access Lines in this Category | Termination Rate per Minute |
|---|---|---|
| **Greater than 5000** | **90%** | **$.002** |
| **500-5000** | **9%** | **$.005** |
| **Less than 500** | **1%** | **$.01** |

[1] A mechanism allowing entities to depart from these charges may be legally required. If so, any departures should be strictly minimized. A provision against undue growth in out of balance traffic is required.

If a negotiated intercarrier agreement cannot be reached, ILECs would be required to adopt these nationally uniform termination charges in order to avoid unnecessary costs associated with individual state proceedings for each company. They are reasonable approximations of the rates that meet the Section 252 (d)(2) standard of "additional costs of such calls." Carriers remain free to negotiate other arrangements, as described in 5. below.

4. **All CLECs, including but not limited to CMRS providers and cable telephony providers, should be permitted to adopt a unified termination charge no greater than that of the ILEC serving the same area.**

This CLEC policy is based on CBICC's presentations at our Task Force meetings.

5. **Carriers should be free to negotiate other intercarrier compensation arrangements, including bill and keep, on a voluntary basis. Agreements should be filed with State commissions for review. State commission review and approval should be in accordance with the standards set forth in Section 252(e) of the Communications Act.**

6. **Intercarrier compensation agreements should be filed with State commissions for review and approval and subject to the standards of Sections 251 and 252 of the Communications Act.**

State commission review and approval is currently in place for reciprocal compensation agreements and has worked well.

7. **LECs should be permitted to convert the per minute termination charges described in 3.–4. above to equivalent capacity charges at any time. That conversion can be either just for ports dedicated to a single carrier's terminating traffic, or for these ports, two-way ports, and common ports. The FCC should conduct a proceeding to determine how per minute termination charges will be converted to capacity charges on a revenue neutral basis. The goal is to convert all per-minute termination charges to port charges within five years.**

This policy of converting from per minute intercarrier compensation to capacity or port charges is based on the EPG plan. Capacity charges more closely follow cost causation and avoid many of the administrative and enforcement problems associated with per minute charges. Capacity charges also provide a mechanism to charge for facilities provided in a packet switched environment where minutes of use have no meaning. As EPG recognizes, suitable methods must be found for applying capacity charges to two-way and common ports. Conceptually, this might be done by reserving portions of the rated capacity of the trunk group for individual carrier's terminating traffic.

8. **State commission participation in a system of unified charges should be voluntary. States that do not participate in a system of uniform charges should not have the authority to participate in the approval of SLC increases described in paragraph 4. of the Universal Service Section below or the authority to distribute Universal Service Funds as described in paragraph 9. of the Universal Service Section below.**

The Communications Act does not allow the FCC to preempt State commission authority over intrastate access charges. This intercarrier compensation proposal establishes strong incentives for states to participate voluntarily in a unified intercarrier compensation regime based on genuine federalism. In that way the plan is based on a traditional form of federalism similar to that used for highways, natural resources protection and education.

9. **No LEC should be required to terminate calls if the call records do not permit billing for terminating access, so long as it participates in an industry process designed to identify calls that have been blocked for this reason and provide real-time resolution. If the carrier seeking to terminate traffic to the LEC disputes the LEC's determination, it should have the option of referring the dispute to the appropriate State commission for resolution. Upon receiving notice that the dispute has been referred to a State commission, the LEC should carry the disputed traffic until the State commission has acted.**

This provision would establish a process that resolves the issue of compelling LECs to terminate traffic for which they do not receive compensation. This issue is resolved in the longer term by adopting capacity or port charges.

10. **Transiting carriers should not be the guarantor for the intercarrier compensation of the terminating LECs.**

The reason for this was discussed at the Task Force meeting in Nashville. This addresses transiting tandem owners' concern that they will have to pay subtending terminating LECs even if the originating carrier does not pay them. If transiting carriers undertake to collect charges for terminating RLECs, they will not be financially responsible for uncollectibles.

11. **A transition process should be established over a period of up to three years based on financial analysis of the plan's impacts. Carriers should track data during the three-year period to accurately adjust compensation if adjustments are necessary at the end of the transition process.**

As was discussed in Missoula, the Task Force does not have in its possession the data necessary to conduct a financial analysis of the plan's impacts. If sufficient support exists for the concepts outlined in this intercarrier compensation proposal proposal, a financial analysis should be conducted and a suitable transition plan devised.

**<u>Universal Service</u>**

1. **Universal service funding should be technology neutral. Carriers should not experience changes in universal service funding based upon technological changes in their networks, i.e., converting from circuit-switched to IP. Funding should be based on the most cost effective and efficient way to provide supported services. The technology employed must be capable of evolving to provide broadband services and must not constitute a barrier to providing advanced services. Definitions of supported services should be modernized and made technology neutral.**

ARIC made effective presentations at our meetings in Washington and Nashville about the need for universal service funding to be technology neutral.

2. **The basis for universal service contributions should be expanded. A unit charge for connections, bandwidth, and possibly telephone numbers is the best approach proposed to date.**

There has been general recognition during our Task Force meetings that the current interstate revenue base of the Federal Universal Service Fund cannot be relied upon for the future. Connections, bandwidth, and possibly telephone numbers have been identified as potential replacements. An example is the ICF plan. More work needs to be done on the shift of revenue recovery from business to residential subscribers and the sustainability of a charge on telephone numbers. The concept of a weighted rate for business connections, as suggested at our Task Force meetings by Cox Communications, should be explored.

3. **A "Rural Access Charge Transition Fund" should be created within the Federal Universal Service Fund that would offset reductions in tariffed access charges experienced by rural eligible telecommunications carriers ("ETCs"). This fund would guarantee revenue neutrality for rural ETCs for a minimum three-year period so long as a company's earnings, in the judgment of the individual state commission, are not unreasonable.**

This approach maintains base year revenues for rural ETCs from the combination of intercarrier compensation and the Federal Universal Service Fund for a three-year transitional period. As described below, State commissions would have the option to establish revenue neutrality after the three-year period for ETCs in their states.

4. **Non-rural local exchange carriers may increase their Federal subscriber line charges (SLCs) by up to the lesser of $3.00 or the amount of intercarrier**

**compensation losses. Any SLC increase must be concurred in by the State commission and approved by the FCC.**

This provision is intended to allow SLC increases for non-rural companies as an option to the extent that intercarrier compensation losses occur as a result of access charge reform and offsetting revenue increases are determined to be appropriate. States may choose to change intrastate rates as an alternative.

5. **The Federal USF program should absorb the cost of state RLEC access charge reform that has occurred during the past five years.**

This provision is necessary to treat states equitably that have already acted to reduce RLEC intrastate access charges. It has no effect after the FCC has acted to establish a distribution of Universal Service Funds to each state pursuant to 7. below.

6. **Lifeline customers should be exempt from any incremental increase in monthly charges that results from intercarrier compensation restructuring. This exemption includes the net impact of unit charges imposed to fund universal service.**

7. **Within three years, the FCC should establish and put into effect a mechanism for determining the amount of the Universal Service Funds for high cost and low income programs to be distributed to accounts for the benefit of individual states. The total amount of the funds provided to each state each year should be:**
    a. **not less than the funds distributed to recipients in that state in 2004 for the applicable programs;**
    b. **sufficient to ensure that all states have adequate funds to meet the standards prescribed in 254 (b)(3) of the Communications Act.**

As discussed below, State commissions are in the best position to determine the distribution of Federal Universal Service Funds intended to provide support in their States. The FCC should determine an overall allocation to each state, based on a funding formula or model and the benchmark for local revenues described in 8.

8. **A national benchmark level for local exchange network cost recovery, inclusive of SLCs and comparable mandatory charges, should be established by the FCC as a basis for determining the need for universal service support after the initial three-year period.**

This idea was put forward by ARIC and received substantial support. It more fully aligns the distribution of Universal Service Funds with the statutory policy. This policy also overcomes the objections many have with providing support to LECs with very low local rates.

9. **A State commission that participates in unified intercarrier charges should determine the distribution of funds within its state subject to FCC guidelines and review. State commissions should be free to reallocate resources between funds.**

Accountability to the public for the use of Universal Service Funds is extremely important. State commissions are in the best position to determine the best use of Universal Service Funds within their states.

10. **Where a state does not establish an allocation of funds as described above or the state allocation is inconsistent with Section 254(b)(3) of the Communications Act, the FCC should establish a mechanism to allocate the funds available for that state.**

This provision allows the FCC to determine the distribution of funds within a state that, for any reason, does not act.

11. **States should condition distribution of universal service` funds on an appropriate demonstration that the carrier is providing quality services at reasonable rates throughout their supported areas. Carriers receiving support for rural exchanges must demonstrate that the funds received are being used for rate relief or infrastructure development in those exchanges.**

12. **States that participate in unified intercarrier charges should be allowed to adopt a state specific increment to the contribution mechanisms for Federal USF that would be applicable to connections in that state and used to supplement Federal USF funds in that state.**

It may be very difficult for a state to maintain a separate universal service fund in the future. This provision allows a state to impose an increment to the Federal Universal Service charge, applicable only within that state, if the State commission finds that it is necessary in order to supplement the funds received from the Federal Universal Service program.

13. **Support provided to high cost rural areas should not be based on whether that area is served by a "rural" or a "non-rural" carrier.**

A deficiency of the current approach to universal service is that support is often not provided for rural high cost exchanges if a "non-rural" carrier serves them. The adverse consequences of this deficiency have been widely discussed. It is unreasonable to expect non-rural carriers to subsidize their rural high cost exchanges in a competitive environment.

14. **USAC or its successor designated by the FCC should remain as the administrator of the USF and the actual entity receiving and disbursing**

**money. Disbursements would be made subject to direction by the responsible State commission or, where the State commission does not act, by the FCC.**

15. **The FCC should permit carriers to be eligible for participation in individual USF mechanisms without being eligible for participation in other mechanisms.**

As an example, consideration should be given to allowing carriers to receive Lifeline funding even if they are not eligible telecommunications carriers for purposes of high cost support.

## Transport and Tandem Transit[2]

1. **The ICF proposal with regard to transport and tandem transit should be adopted as proposed subject to any consensus modifications and 2. below.**

A complete proposal must address the issues of transport and tandem transit. The ICF proposal is the only complete proposal put forward to date and so it is tentatively adopted, for the time being at least, in this intercarrier compensation proposal. Tentative adoption of the ICF proposal explicitly includes the edge definitions for hierarchical, non-hierarchical, and rural carriers.

2. **The ICF proposal that "(t)he weighted average of common and dedicated switched terminating transport rates across a [CRTC] holding company may not exceed $.0095 per terminating minute" is retained in those situations where the distance involved is less than 200 miles and islands or roadless areas are not involved. Where the distance is 200 miles or greater or involves islands or roadless areas, the weighted average may not exceed $.019.**

This provision is intended to address the extreme cases identified by ARIC where the terminating transport distances for some CRTCs are very long.

3. **Tandem owners must participate in a program designed to eliminate phantom traffic, including performing screening of call records if necessary.**

## Procedural Issues

1. **The FCC should consult with the Federal-State Joint Boards on Universal Service and Separations prior to adopting a plan for intercarrier compensation reform.**

2. **After adoption of a plan for intercarrier compensation reform, the FCC should formally ask both Joint Boards for Recommended Decisions dealing**

[2] Unique circumstances exist in Alaska that may require modification of this section, and potentially other sections as well, for application in that state.

**with impacts of the intercarrier compensation reform plan in their areas of responsibility.**

Adoption of an intercarrier compensation reform plan by the FCC carries significant implications for policies that are part of the responsibilities of these Joint Boards. It is important that these Joint Boards be allowed to adopt Recommended Decisions for the FCC that deal with implementation issues.

## II. Appendix To TASK FORCE Draft Version 5 Originating Access

**Proposed substitute for Origination and Termination - paragraph 2, as follows:**

**2. For 1-plus toll access, all ILECs should be required to adopt an originating rate of $0.002. Payments would be made by the retail service provider, meaning the carrier who is receiving (or could receive) compensation from the end user. Payments would be made to the ILEC or to any CLEC that controls the end user's originating facilities through UNE purchases. For uses of the network other than 1-plus access, ILECs should be required to adopt an origination rate of zero.**

**2.1 Where at least 50 percent of a carrier's service area (measured by customer locations) is subject to broadband competition, the carrier may elect to reduce its originating rate to zero.**

Comments on paragraph 2.

The plan proposes to retain an originating access charge for 1-plus calling, sometimes called "presubscription" dialing. It is an obligation imposed by the government on most wireline LECs and allows other carriers, notably IXCs, to sell retail telecommunications services to a LEC customer.

The originating rate would be uniform and fully integrated. The amount of originating access would not depend upon the originating LEC, the IXC that uses the LEC, the location at which the call terminates, or the legal classification of the IXC's terminating carrier.

The originating rate of $0.002 is lower than most existing interstate access rates, and substantially lower than some intrastate access rates.[3] Rate reductions are proposed to reduce the tendency of originating intercarrier compensation charges to promote bypass to other networks, such as cable modem, DSL and special access. While the risk of bypass is increasing, especially for large-volume customers, it is not yet clear that the risk is so great, and the ultimate perceived harm is so severe, that the public interest requires immediate elimination of all originating access revenues.

The plan has a three-band rate structure for termination; but no bands apply to origination.[4] While originating cost can vary as much as terminating cost, the economic effects are different. Section 254(g) of the Act mandates that toll rates will be uniform nationally. This imposes a burden on IXCs that originate or terminate traffic in high-access areas. Most IXCs have approximately equal average costs for termination, and therefore there are relatively minor competitive issues with termination. But IXCs suffer disproportionate harm from originating access charges if they accept a presubscription customer from a high-access area; every minute a customer uses is a high-cost minute. The IXC of a customer in a high-access LEC area thereby becomes an involuntary insurer of the national policy of uniform toll pricing. As a result, some IXCs have taken steps to

[3] The origination rate requires the LEC to transport the call to the IXC's Point of Presence, which ordinarily is at a tandem switch. This can actually require more facilities and have greater cost than termination, which, under the plan, occurs at the "Edge." The Edge for a CRTC is much closer to the LEC's central office.

[4] This is equal to the rate for termination in high-density areas; origination and termination rates would match for about 90 percent of access lines.

limit subscribership in high-access areas, and rural customers often cannot obtain favorable calling plans from national IXCs. A three-banded origination rate would maintain this incentive to discriminate against customers in rural areas. To correct for this, some kind of IXC pooling or insurance mechanism would also be needed,[5] and the resulting plan would be more complex. Instead, the plan calls for a single unified rate of $0.002, thereby avoiding any incentive for IXCs to discriminate against high-cost areas.

The NARUC principles require an originating LEC must be able to "recover an appropriate portion of [its] applicable network costs" from intercarrier compensation.[6] Along similar lines, the NARUC principles also require intercarrier compensation to satisfy 47 U.S.C. § 254(k).[7] That subsection requires a toll provider to make at a reasonable contribution to the joint and common cost of providing services (such as local exchange) that are supported by universal service.[8] For most or all carriers, a rate of $0.002 satisfies these tests. By contrast, a zero origination charge cannot meet any of these standards.

The NARUC principles state that a compensation plan should minimize arbitrage opportunities and be resistant to gaming.[9] A zero origination charge fails this test. Presubscription means that an IXC's customer can require its LEC to carry any 1-plus call to the IXC's POP, ordinarily at a tandem switch. At a zero access rate, neither the IXC nor the customer has any reason to limit use of the local circuit, and the customer need never "hang up" the call. This could produce four harmful effects. First, it would be inefficient. Demand would increase on local switches, tandem switches and tandem trunks, but the cost-causer would not pay the incremental cost. Second, it would promote arbitrage between switched and special access circuits. A customer could turn a switched circuit into a 24x7 dedicated special access circuit that ties up switching resources. Third, it would waste resources because it provides an incentive to use the switched network in ways inconsistent with its engineering design. Customers would be encouraged to waste expensive switching resources on circuits that are seldom or ever taken down. Fourth, it would promote gaming because end users will have an incentive to masquerade as IXCs. A bank, for example, with a private network could incorporate an affiliated IXC. The affiliate could substantially reduce the bank's costs for communication between branches and the tandem switch. The IXC would have access, for example, to free and continuous use of tandem trunks it otherwise would have to purchase under special access tariffs.

The NARUC principles state that intercarrier compensation charges should be competitively and technologically neutral.[10] A nonzero originating charge satisfies this requirement by applying the same rules to all IXCs. Moreover, the 1-plus

[5] Such a mechanism would be further complicated by the law's insistence that only ETCs, not IXCs, may receive universal service support.

[6] NARUC Principles, ¶ III.B.

[7] NARUC Principles, ¶ III.B.

[8] *See,* 47 U.S.C. § 254(k). ("The Commission, with respect to interstate services, and the States, with respect to intrastate services, shall establish any necessary cost allocation rules, accounting safeguards, and guidelines to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services.")

[9] NARUC Principles, ¶ III.A.

[10] NARUC Principles, ¶ III.D.

presubscription obligation arises from a government mandate,[11] and the originating access charge would apply in the same cases.

A nonzero originating charge will also reduce the demand on universal service funding. By providing LECs with an additional source of revenue from network users, less intercarrier revenue will be lost, thereby reducing the demand on universal service.

Sections 251 and 252 of the Act contain standards for the pricing of interconnection charges. Section 252 provides that the terms and conditions of an interconnection agreement must:

> provide for the mutual and reciprocal recovery by each carrier of costs associated with the transport and termination on each carrier's network facilities of calls that originate on the network facilities of the other carrier.

Section 252 does not address charges for origination. However, a nonzero origination charge is compatible section 252 because of the different context. Sections 251 and 252 address intercarrier compensation in a two-carrier context. They do not speak to the specialized case of governmentally mandated division between one carrier that owns the facilities and another carrier that has the right to have its own retail customer use those facilities.

Some observers expect that presubscription or 1-plus toll dialing by independent IXCs will decline in the future, possibly to zero. If this is accurate, the economic significance of the originating access charge will similarly decline.

<u>Comments on paragraph 2.1.</u>

Broadband competition can cause bypass of originating charges. Where a carrier faces significant broadband competition, it may be in the carrier's best interest to minimize that bypass. The plan would allow carrier to reduce or eliminate the $0.002 in areas with significant broadband buildout. As described elsewhere in the plan, and depending on the circumstances, universal service support, or SLC increases, might offset some of these losses.[12]

The threshold for actuating the originating access reduction is 50% buildout of broadband, by customer location. This threshold requirement could be met by any and all forms of constructed broadband, including cable modem broadband and DSL. Given typical "take" rates of 20 percent for broadband, a 50% buildout rate would normally translate into approximately 10% of customers actually subscribing to broadband. The plan assumes that at this market penetration level a carrier might need to further reduce its originating access charges. The threshold prerequisite is added to avoid needless stress on universal service funds.

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[11] For carriers without an equal access mandate, such as CMRS carriers, the originating access charge is functionally infinite because an IXC cannot ordinarily obtain a presubscription customer at any price.

[12] For example, if a rural carrier made the election in the first year, the RACTF would fully offset the loss until the RACTF itself expires.